



CalPERS Securities Lending and Corporate Governance Summary

Proxy Voting

August 18, 2008

Securities Lending Summary

■ Why do market participants borrow stock?

Facilitate market transactions:

- Support Hedge Fund and Prime Broker activities
- Arbitrage activity
- Covering fails
- Merger and acquisition activity
- 130 / 30 strategies
- Participate in market neutral and other program trades



Securities Lending Summary

- **Operationally – what happens when a stock is borrowed?**
 - CalPERS and borrower agree to the terms of a loan secured with cash collateral
 - The agreement requires borrower at termination of loan to return like quantity of the same security
 - CalPERS retains the right to recall or terminate a loan in order to exercise a Proxy.
 - Upon receipt of cash collateral from the borrower, CalPERS delivers the securities
 - CalPERS reinvests cash collateral
 - When loan terminates, borrower returns securities to CalPERS (thus returning title) and cash collateral is returned to borrower



CalPERS Goals

- Balance shareholder responsibility while optimizing value of CalPERS' assets:
 - Maximize income from securities lending fees
 - Maintain a proactive corporate governance effort



CalPERS Securities Lending History

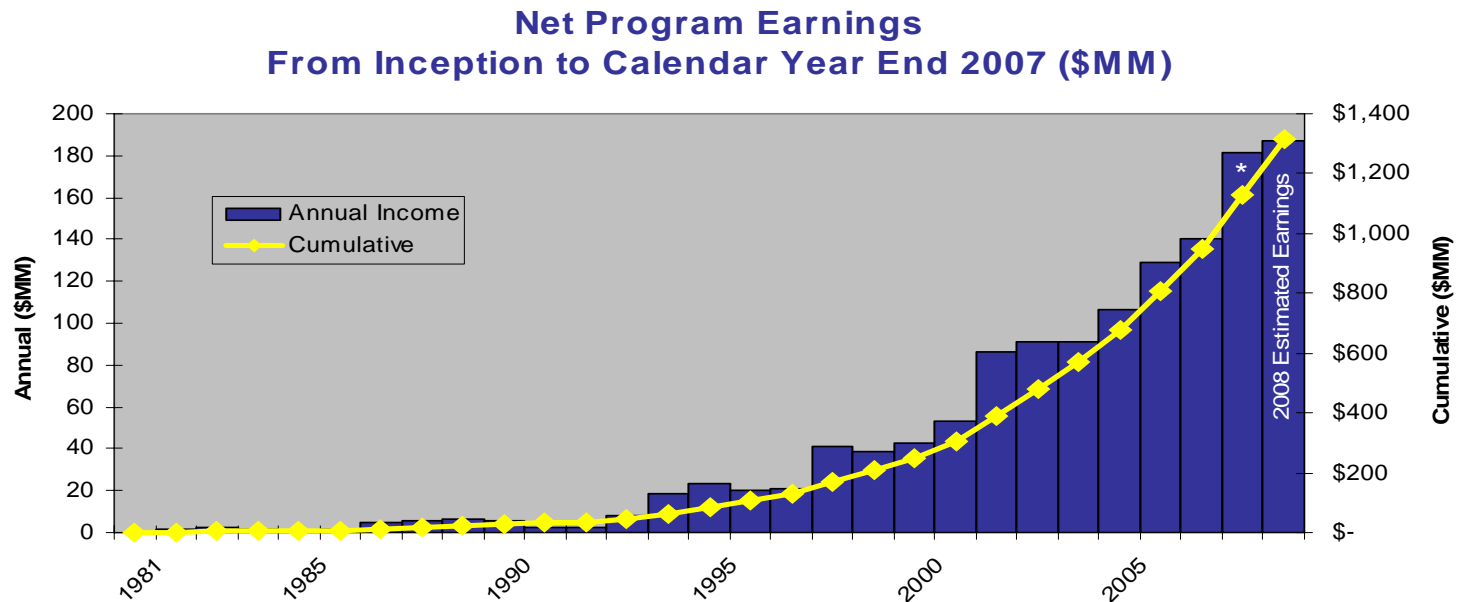
The CalPERS Securities Lending Program started in the early 1980's. The program was initiated in an effort to earn additional income on the existing CalPERS portfolios. Recognizing the potential for substantially greater income from an actively managed, lending approach, CalPERS co-developed an auction-based model with United Asset Management. That effort came to be known as eSecLending (eSec). CalPERS and eSec developed an online, web-based system as a means to maximize the value of lendable assets through an auction based platform.

The first few auctions were tremendously successful and immediately boosted returns. Revenue increased by 63% the first year the auction process was utilized. The increased price transparency of the auction format allowed CalPERS to realize the true value of its lendable asset base. By increasing the number of counterparties and creating portfolio subsets that matched borrower needs, CalPERS extracted additional value from its existing asset base.

The winner of an auction has exclusive "access" to borrow securities from a specific fund for a fee. Any securities borrowed will transfer title, any positions not borrowed will remain in the respective CalPERS fund. The title of a security will transfer only when borrowed, not upon an auction award.

CalPERS Securities Lending History

Over the last eight years, CalPERS has auctioned off \$779 billion in assets through 30 separate auctions. CalPERS Securities Lending cumulative net earnings are nearly \$1.2 billion dollars. Over 73% of the total cumulative income has been generated in the last eight years, since moving to the auction based platform.



* Annual and cumulative earnings do not include unrealized loss on the internal collateral reinvestment fund.

CalPERS Approach to Corporate Governance & Securities Lending

- Collaborative effort from Corporate Governance and Securities Lending units
 - Corporate Governance prepares Restricted and Proxy Recall Lists
 - Internally Restricted List
 - CalPERS Target list
 - Securities are unavailable for lending
 - Proxy Voting List
 - Composed of the top companies by market capitalization in the internal domestic equity portfolio; 300 names
 - Recalled prior to record date to ensure vote is captured
 - International Holding List
 - International Target list
 - Recalled for proxy voting purposes
 - All lists are reviewed and updated annually by the Corporate Governance Unit
 - The Securities Lending Group distributes all lists to potential borrowers prior to auction

CalPERS Approach to Corporate Governance & Securities Lending

- Flexibility between Corporate Governance and Securities Lending
 - Securities Lending request
 - Securities Lending may request a security on the proxy voting list be temporarily removed from the proxy voting list
 - Request will include financial benefit to lending the security
 - Corporate Governance determines if it's more beneficial to lend the security or vote the proxy
 - Corporate Governance request
 - Corporate Governance can request that a security be added to the proxy voting list at any time
 - If the security is out on loan, Securities Lending will recall the security in order to vote the proxy

CalPERS Approach to Corporate Governance & Securities Lending

- CalPERS staff defines the roles and responsibilities between the various stakeholders
- Transparent guidelines are supported by strong operational procedures to ensure proper recalls and restrictions
 - Communicated on auction website
 - All stakeholders are aware of CalPERS intentions with regards to recalls during Proxy Season
 - Compliance Monitoring
 - Restricted List, Domestic and International Proxy Voting List securities are input into compliance monitor platform
 - Securities Lending staff monitors
 - Frequent correspondence between CalPERS staff, program administrator and borrowers

Industry Best Practices

■ Federal Regulations:

- Prohibit a broker from borrowing securities merely to have the securities on hand or in anticipation of a future need that may or may not arise
 - Define who may lend and borrow securities
 - Outline provisions on acceptable purposes for borrowing securities
 - No purpose to borrow = no borrowing
- Establish uniform “locate” and “close-out” requirements to mitigate issues associated with naked short selling
 - Locate requirement: Broker-dealer to have reasonable grounds to believe a security can be borrowed and delivered by settlement date on a short sale
 - Close-out requirement: Imposes additional actions to close out any delivery fails on a short sale
 - Requires broker-dealer to purchase securities of like kind and quality after fail period
 - Temporary suspension of ability to process short sales until fails are settled

Industry Best Practices

- CalPERS takes additional measures to safeguard assets
 - Agreements with the borrowers
 - Borrower will not borrow a Loanable Security for the purpose of accumulating proxy votes
 - CalPERS may recall any security at any time
 - Monitoring for compliance
 - CalPERS staff monitors borrower activity to ensure securities are not borrowed solely for proxy voting

Industry Best Practices

- In addition to SEC regulations, there are industry organizations that provide information on best practices
 - International Corporate Governance Network (ICGN)
 - www.icgn.org
 - International Securities Lending Association (ISLA)
 - www.isla.co.uk
- These organizations have common themes regarding securities lending best practices
 - Communication
 - Transparency
 - Consistency
 - Responsibility
 - Borrowing shares for the purpose of acquiring votes is inappropriate

CalPERS Follows Best Practices

■ Industry best practices themes

□ Communication

- Between corporate governance and securities lending departments
- Between securities lending and borrowers

□ Transparency

- All corporate governance related information posted on auction websites for borrowers to see

□ Consistency

- Policies in place

□ Responsibility

- All parties involved understand the process and their respective roles

□ Borrowing shares for the purpose of acquiring votes is inappropriate

- Legal language signed with borrower & activity monitored

CalPERS Practices



CalPERS Position within Industry

- CalPERS Securities Lending and Corporate Governance collaboration is leading innovator
 - Featured in publications detailing CalPERS' proxy voting and securities lending process
 - Participated in “Best Practices Panel” at industry conferences (e.g. IMN Beneficial Owners Conference)

The Wall Street Journal

Investor Services Journal

Information Management Network

Conclusion

- Securities Lending and Corporate Governance co-exist collaboratively and successfully, allowing CalPERS to be a model beneficial owner.
- CalPERS leads the industry regarding both securities lending and corporate governance best practices.
- Fiduciary responsibilities are balanced between:
 - Enhancing total return through securities lending fee revenue
 - Protecting CalPERS' interest as a shareowner through corporate governance